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## Shortcomings in the EU Merger Directive

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2016

### **document version**

Publisher's PDF, also known as Version of record

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### **citation for published version (APA)**

Boulogne, G. F. (2016). *Shortcomings in the EU Merger Directive*. [PhD-Thesis - Research and graduation internal, Vrije Universiteit Amsterdam]. Kluwer Law International.

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## Chapter 7: Overall conclusion

### 1. Introduction

To reiterate, the main question of this thesis was:

*On which points does the Merger Directive fall short of attaining its stated objective and how can these shortcomings be solved?*

This main question was subdivided into five sub-questions, which were answered in five separate Chapters (Chapters 1 – 5). The findings in these Chapters – sometimes at a conceptual level, sometimes at a more detailed level – are reflected in the concluding Sections of each of those Chapters. These conclusions are largely replicated here (Section 2). In this Chapter, it is also time to draw overall conclusion; as regards the main *shortcomings* and their *possible solutions* (Section 3).

### 2. Summary of conclusions

#### 2.1. Chapter 1 – The scope *rationae personae*

##### *‘Company’*

The term ‘company’ can have different meaning in different legal systems. Within the scheme of the Merger Directive, the term ‘company’ appears to be a generic term. The other EU directives do not add much clarity on the interpretation of the term ‘company’ in the Merger Directive. As the provisions in the Merger Directive governing the tax treatment at company level relate exclusively to operations that constitute methods of exercise of the freedom of establishment, it is rational to interpret the term ‘company’ as encompassing all entities that have access to the freedom of establishment pursuant to Article 54 of the TFEU. In the light of the objective of the Merger Directive, the term ‘company’ should cover all entities that can carry-out cross-border restructuring operations. Given the confusion and legal inaccuracies attached to the use of the term ‘company’ it is recommended to either use the definition of the term ‘company’ in Article 3(1)(b) of the OECD Model Convention or to replace the term ‘company’ by the term ‘entity’.

##### *‘Listed form requirement’*

The consequence of being listed in Annex I, Part A, is not that a company can automatically qualify for each of the operations covered by Article 2 of the Merger Directive, although being listed in the Annex does imply that a company should at least qualify in one capacity. It can be inferred from the *Gaz de France* decision that the list of companies covered by Annex I, Part A, should be interpreted limitatively. There does not seem to be a teleological ground for limiting the scope of the Merger Directive to companies taking a listed legal form. In any event, it does not seem possible to justify the clear discrimination of companies incorporated under the laws of a third country, on the basis of their nationality. Their exclusion may deter companies that are incorporated under the laws of a Member State from engaging in cross-border restructuring operations. The ‘listed form requirement’ is possibly also in breach of the freedom of capital movement if carry-over relief is not available because the restructuring operation does not

involve two or more companies that satisfy the ‘listed form requirement’. The discrimination of companies that are incorporated under the laws of a third country does not seem to be in breach with the general prohibition of discrimination on nationality grounds in Article 18 of the TFEU. In the present author’s view, the exclusion from the Merger Directive’s scope of companies incorporated under the laws of a third country also constitutes a breach of the unwritten EU law principle of equality. The wide margin of discretion typically conceded to EU institutions in adopting legislation seems to justify the merely partial coverage of companies incorporated under the laws of a Member State. If a Member State has concluded a tax treaty with a third country, a provision corresponding with Article 24(1) of the OECD Model Convention prevents the Member State from discriminating, on the basis of its nationality, a company that is incorporated under the laws of the third country. Also if a tax treaty is concluded between two Member States, a provision corresponding with Article 24(1) of the OECD Model Convention prohibits a Member State from discriminating a company that is incorporated under the laws of a Member State that is not covered by the Annex and that is resident in the other Contracting State. Given the breaches of the ‘listed form requirement’ with the objective of the Merger Directive, the freedom of establishment, the freedom of capital movement, the unwritten EU law principle of equality and the treaty non-discrimination provisions in Article 24(1) of the OECD Model Convention, it is recommended to abolish the ‘listed form requirement’.

#### *‘Residence requirement’*

The ‘residence requirement’ does not preclude dual residence within the EU. If a company meets one of the criteria for tax residence in a Member State and one of the criteria for tax residence in a third country and no tax treaty has been concluded between the Member State and the third country, this company will still meet the ‘residence requirement’ if it is considered to remain resident in the Member State for tax purposes according to the tax laws of that Member State. However, if a tax treaty is concluded between the Member State and the third country, the company does not meet the ‘residence requirement’ if it is considered to be resident for tax purposes in the third country under the terms of that tax treaty. If a tax treaty between a Member State and a third country contains a MAP as tie-breaker, it depends on how the competent authorities settle a dual-resident company’s residence, whether the ‘residence requirement’ is met. If the tax treaty residence is not settled or has not yet been settled, the ‘residence requirement’ is literally not met, as under the terms of a double taxation agreement, the company is (also) considered to be resident for tax purposes outside the EU. Nonetheless, as the Member State is still allowed to tax the business profits of the dual-resident company, there appears to be no reason to deny the benefits of the Merger Directive. If failure to reach mutual agreement has the result that the dual-resident company is not entitled to claim any benefits under the tax treaty, the ‘residence requirement’ should be met as the dual-resident company “is not considered to be a resident for tax purposes outside the Community” “under the terms of a double taxation agreement concluded with a third country”. If the tax treaty between a Member State and a third country contains a ‘place of incorporation tie-breaker, a company that is incorporated under the laws of a Member State, but satisfies one of the criteria for tax residence in the third country, will meet the ‘residence requirement’. If the aim of the Merger Directive is to confine the scope of the Merger Directive to companies bearing a sufficient nexus to the internal market, the ‘residence requirement’ in its current form is not suitable and goes beyond what is necessary to attain that objective. Such an aim would be difficult to align with the unconditional relief at

shareholder level, which extends to shareholders that are resident in third countries. The ‘residence requirement’ does not contribute to the safeguarding of taxing rights nor does it prevent tax avoidance. Owing to the ‘residence requirement’, certain cross-border restructuring operations are placed outside the scope of the Merger Directive, although links with the internal market exist, either at company level or at shareholder level. It is, therefore, recommended to abolish the ‘residence requirement’.

#### *‘Subject-to-tax requirement’*

Although the tax benefits granted under the Merger Directive cover taxes levied on companies as well as on their shareholders, a company will only meet the ‘subject-to-tax requirement’ if it is subject to a listed corporation tax or a tax replacing it. A literal reading of the term ‘subject to tax’ does not provide an answer to various questions that arise, such as whether a company that is subject to tax because of its legal form, but of which its taxable object is exempt, is subject to tax, or whether a company that is only subject to a limited tax liability is subject to tax. In the light of the objective of the Merger Directive, the ‘subject-to-tax requirement’ is not self-evident since fiscal obstacles to cross-border restructuring – both at company level and at shareholder level – may also occur if not two or more of the companies involved are ‘subject to tax’ and the ‘subject-to-tax requirement’ has no role in safeguarding taxing rights. The optionality of taxation or the availability of an exemption deprives a company from complying with the ‘subject-to-tax requirement’. Arguably, a company that exercises a right to elect for corporate taxation, does not meet the ‘subject-to-tax requirement’. A company that does not exercise an option to be subject to personal income tax (at the level of its shareholders/participants), however, should meet the ‘subject-to-tax requirement’. It is recommended to abolish the ‘subject-to-tax requirement’.

#### *‘Involving companies from two or more Member States’*

The wording and the scheme of the Merger Directive suggests that the requirement of ‘involvement’ should be met at the level of the companies that are involved in the restructuring operation, and that it does not refer to the shareholders of the restructuring companies. If a company meets the three requirements of Article 3 of the Merger Directive in multiple Member States, the question arises: is it a “company from one or from multiple Member States?” The wording of the Merger Directive suggests that a company can only be a ‘company from one Member State’, although neither the ‘listed form requirement’, the ‘residence requirement’ or the ‘subject-to-tax requirement’ would be suitable as the decisive criterion to determine to which Member State a company belongs. A company that meets the three requirements of Article 3 of the Merger Directive should, therefore, be regarded as a “company from multiple Member States”, automatically triggering the application of the Merger Directive. Even if a certain part of a restructuring operation should be viewed as ‘domestic’, the wording used in Article 1(a) of the Merger Directive only requires that companies from two or more Member States be involved in the restructuring operation and it does not require each of the companies involved in the restructuring operation to be resident in a different Member State. Accordingly, the facilities of the Merger Directive should not be granted only partially. Also cross-border restructuring operations that involve companies from third countries or non-qualifying companies from Member States fall within the scope of the Merger Directive, provided that companies from two or more Member States are involved. As a result of the ‘involvement requirement’, certain cross-

border restructuring operations are left outside the scope of the Merger Directive – in spite of a cross-border element – and the root of these flaws is that the application of the different carry-over facilities in the Merger Directive (at company level, at shareholder level, and at the level of a transferred permanent establishment) is made dependent on one condition: the involvement of companies from two or more Member States. Abolishing the ‘involvement requirement’ would take away these flaws, and would mean that a uniform set of rules would apply to the restructuring operations listed in Article 2 of the Merger Directive, irrespective of a cross-border element. A more conservative option would be to confine the extension of the Merger Directive’s scope to restructuring operations that have a cross-border element.

## UCITS

The UCITS IV Directive offers an improved framework laying down provisions to facilitate mergers between undertakings for collective investment in transferable securities and investment compartments thereof. Whether a UCITS will qualify as a ‘company from a Member State’ should be assessed on a case-by-case basis. It is not possible to answer in general the question whether the Merger Directive is capable of removing the fiscal restrictions on cross-border mergers of UCITS.

### 2.2. Chapter 2 – The scope *ratione materiae*

#### ‘Merger’

As a result of the ‘non-liquidation requirement’ in Article 2(a) of the Merger Directive, cross-border liquidations are outside the scope of the Merger Directive. Yet, as these operations can be commercially desirable and they can be regarded as acts of establishment in the present author’s view, the scope of the Merger Directive should be extended to cross-border liquidations.

The limitation of the nature of the allowable consideration to securities may serve to prevent *de facto* sales of assets and liabilities, in which case the liquidities become available to pay the tax debt. Another explanation is that this requirement is necessary to make sure that a group relationship is established between (the shareholders of) the transferring company and the receiving company. At company and at shareholder level, however, the nature of the consideration is irrelevant when it concerns the safeguarding of taxing rights. Even if the shareholder receives liquidities, the transferring company does not benefit from this (its shareholders do) and it would, therefore, be disproportional if carry-over relief at company level would be unavailable. The requirement of a group relationship cannot be deduced from the wording or the preamble to the Merger Directive and the Merger Directive also covers operations, such as an ‘exchange of shares’, whereby a group relationship between the shareholder and the acquiring company is expressly not a prerequisite.

The ‘10% cash payment limitation’ is unnecessary to safeguard the taxing rights of the Member States. The reference to the nominal values of the securities may lead to arbitrary outcomes and it is difficult to appreciate why higher nominal values of the securities issued justify a higher allowable cash payment to iron out rounding differences. In addition, the desired effect of the ‘10% cash payment limitation’ can be eroded if the receiving company increases the nominal

values of its securities. Given these objections, both the general restriction of the nature of the allowable consideration to securities and the ‘10% cash payment limitation’ should be removed.

Given the literal approach taken by the ECJ with the interpretation of the scope of the Merger Directive (the reasons for a restructuring operation are disregarded), it should be possible to use the allowable 10% cash payment to buy out minority shareholders, especially since Article 8(9) of the Merger Directive allows for the taxation of the shareholders on the cash payment.

The reason why reference is made to the term ‘securities’, instead of the more common term ‘shares’, could be to make the benefits of the Merger Directive also available in the case of restructuring operations that involve any of the non-capital based companies listed in Annex I, Part A. In the light of the objective of the Merger Directive, the term ‘securities’ would cover any consideration other than ‘liquidities’, even if this would result in the change of the applicable tax regime at the level of the shareholder.

The ‘issuance requirement’ constitutes a needless administrative obstacle if the shareholders of the transferring company already hold all the securities in the receiving company (merger, division, partial division), if a transferring company transfers a branch of activity to its wholly-held subsidiary (transfer of assets), or if a shareholder transfers a holding in the capital of the acquiring company to a wholly-held acquiring company (exchange of shares). If a company is not able to issue securities representing its capital, the ‘issuance requirement’ is a showstopper, even though taxing rights can be safeguarded.

As a result of the ‘issuance requirement’, so-called ‘triangular mergers’ do not qualify under Article 2(a) of the Merger Directive. However, ‘triangular mergers’ can be fitted within the scheme of the Merger Directive to the extent that the real values of the securities received correspond to the real values of the securities in the transferring company. This implies that the company issuing securities to the shareholders of the transferring company should benefit (directly or indirectly) from the receipt of the assets and liabilities of the transferring company.

It is possible that the values of the transferred assets and liabilities at the level of the transferring company differ from their values at the level of the receiving company or that the values of the securities received at the level of the shareholder differ from the values of the securities exchanged. It is even possible that the values of the securities issued differ from the values of the assets and liabilities received. Based on a literal reading, it could be doubtful if there is a ‘merger’ within the meaning of Article 2(a) of the Merger Directive if the values of the securities issued deviate from the values of the transferred assets and liabilities. Systematically, the valuation of the transferred assets and liabilities or the securities received is not a matter for Article 2(a) of the Merger Directive. The definitions of ‘division’ and ‘partial division’ in Articles 2(b) and 2(c) of the Merger Directive refer to the “*pro rata*” issue of securities, a phrase which is omitted in Article 2(a) of the Merger Directive. This could indicate *a contrario* that with a merger, the values of the securities issued may be disproportional to a shareholder’s interest in the underlying assets and liabilities in the transferring company. This could also be an extra clue that the phrase “in exchange for” implies that an equal share exchange ratio is the norm; a conclusion that is supported when one considers the EU corporate law framework. When taking into account the objective of the Merger Directive to safeguard the financial interests of

the Member States, there is an obstacle to allow a merger whereby the values of the securities issued deviate from the values of the assets and liabilities transferred, namely the reduction of the taxing rights of the shareholder that receives a less valuable shareholding. This obstacle can be overcome by allowing a Member State to take into account when taxing a shareholder on a difference between the real values of the securities received and the real values of the securities exchanged.

*‘Division’ and ‘partial division’*

In spite of the definition of ‘branch of activity’ in Article 2(j) of the Merger Directive, not all doubt regarding its meaning is taken away, nor is the role of the ‘branch of activity requirement’ self-explanatory in the light of the objective of the Merger Directive.

The ECJ’s finding in the *Andersen og Jensen* decision that a transfer of assets “must encompass all the assets and liabilities relating to a branch of activity” does not ensue from the wording of Article 2(j) of the Merger Directive, which does not require that all the assets and liabilities that may be attributed to a certain branch of activity be actually transferred. It only stipulates that the assets and liabilities that are actually transferred constitute a branch of activity. Whether or not certain assets and liabilities remain behind should not matter. The reference to the financial position of the receiving company is not logical in the light of the scheme of the Merger Directive. As the transferring company is granted carry-over relief, it may not always be possible for that company to assess whether or not the transferred assets and liabilities operate in a financially independent manner at the level of the receiving company. The (in)dependence of the ‘branch of activity’ should, therefore, be judged autonomously, regardless of the situation of the transferring or the receiving company. Furthermore, the ECJ’s finding that the companies involved could have achieved the same result by engaging in another operation than a transfer of assets contradicts its own settled case-law, as it interwove a subjective element into the objective facts.

The rationale behind the ‘branch of activity requirement’ is ambiguous. Firstly, the explanation that this requirement has been introduced to distinguish between sustained restructuring operations and disguised disposal of assets, and hence, to reflect the Merger Directive’s objective “to allow enterprises to adapt to the requirements of the internal market, to increase their productivity and to improve their competitive strength at international level” is not entirely convincing as, even if certain assets and liabilities cannot function by their own means, their transfer could still improve the productivity or the competitive strength of the companies involved. Secondly, the ‘issuance requirement’ already excludes disguised disposals of assets from the scope of the Merger Directive. This suggests that the ‘branch of activity requirement’ serves a different purpose. Thirdly, as the ‘branch of activity requirement’ is imposed at company level, it is ill-equipped to combat disposals of assets disguised as partial divisions. In such a case, the transferring company’s shareholders, and not the transferring company itself, would benefit from the disguise. What also adds to the systematic lack of clarity is that the ‘branch of activity requirement’ is not imposed in respect of all operations covered by Article 2 of the Merger Directive, although it is not clear what the relevant distinction between these operations is. The relationship between the ‘branch of activity requirement’ and the ‘permanent establishment requirement’ in Article 4(2)(b) of the Merger Directive is not clear either. As the

‘permanent establishment requirement’ is capable of excluding operations that are not sustained, the ‘branch of activity requirement’ appears to be superfluous.

If the requirement that at least one branch of activity be left in the transferring company serves to prevent the conversion of a taxable capital gain to an exempt capital gain, one can find much fault with it. Firstly, the intended result can also be achieved using a ‘division’, but a similar condition is not inserted in the definition of that operation. Secondly, it does not fit within the scheme of the Merger Directive to incorporate an anti-avoidance clause in a provision that defines the scope of the operations covered by the Merger Directive. Accordingly, the requirement that at least one branch of activity be left in the transferring company should be deleted from the definition of ‘partial division’ in Article 2(c) of the Merger Directive. The undesired conversion of a taxable capital gain to a tax exempt gain, if this already qualifies as tax avoidance, should be combated on the basis of Article 15(1)(a) of the Merger Directive.

Dispute divisions, in which the receiving companies issue securities specifically to (a) certain shareholder(s), albeit that all the shareholders eventually receive securities in (at least) one of the receiving companies, can be covered by Article 2(c) of the Merger Directive.

#### *‘Exchange of shares’*

In the case of an ‘exchange of shares’, it may be complicated to determine whether or not the ‘voting rights requirement’ is met, since the shareholders will have to rely on the correctness of the information provided by the acquiring company to assess their eligibility to carry-over relief. In addition, it is not always immediately clear if the ‘voting rights requirement’ is met if the voting rights are divided disproportionately among the shareholders, if the acquiring company has different categories of voting rights or if the majority of the voting rights is acquired through a number of simultaneously carried-out exchanges of shares.

A possible explanation for the ‘voting rights requirement’ is that it restricts the ‘exchange of shares facility’ to situations in which the acquiring company obtains complete control over the acquired company. This would lead to the alignment of the ‘exchange of shares facility’ with the other operations covered by Article 2 of the Merger Directive, each of which should be regarded as a particular method of exercise of the freedom of establishment.

Owing to the ‘voting rights requirement’, the transfer of a shareholding representing five percent of the voting rights in the acquired company is treated differently, depending on whether or not the acquiring company obtains or already holds a majority of the voting rights. As the shareholder will seek carry-over relief pursuant to Article 8 of the Merger Directive, this distinction at the level of the acquiring company is arbitrary. It also seems odd to invoke one of the group criteria (the existence of majority voting rights) in a directive that is not specifically aimed at the grouping of companies. In addition, in the light of the Merger Directive’s objective of contributing to the “establishment and effective functioning of the common market”, it is not self-evident why the acquisition of complete control over the acquired company should demarcate qualifying and non-qualifying exchanges of shares. Also the exchange of a minority shareholding (in the hands of the acquiring company) may constitute a commercially desirable restructuring operation. Accordingly, as the ‘voting rights requirement’ creates an arbitrary



distinction at the level of the acquiring company and is at odds with the scheme and objective of the Merger Directive, it is recommended to remove this requirement.

#### *Transfer of the registered office of an SE or an SCE*

As developments under primary EU law have paved the way for cross-border transfers of the registered office of companies taking a legal form other than an SE or an SCE, also these companies should be able to enjoy the benefits of the Merger Directive when transferring their registered office to another Member State. Nevertheless, the case-law of the ECJ, as it stands, currently does not yet facilitate companies with legally transferring their registered offices from each Member State to each other Member State. Arguably, the expansion of Article 1(a) of the Merger Directive with the other forms of company covered by Annex I, Part A, is necessary to remove an infringement of the freedom of establishment.

#### *Interplay between tax law and corporate law*

Certain elements in the definitions in Article 2 of the Merger Directive, such as the ‘voting rights requirement’ and the ‘non-liquidation requirement’ are unnecessarily restrictive from a tax law perspective. It is, questionable, however, if these definitions can be viewed in isolation from their corporate law counterparts. On the one hand, as no explicit reference is made in Article 2 of the Merger Directive to the corporate law definitions, it may seem unnecessary to have recourse to these definitions when assessing the scope of the Merger Directive’s facilities. On the other hand, there are strong similarities between the definitions in the Merger Directive and those under corporate law and it may be undesirable to end up with diverging interpretations.

Given the similarities between certain definitions in the Merger Directive and their counterparts in the EU corporate law framework, the interpretation of these definitions should in principle be interchangeable. However, as their schemes and objectives may differ, such a uniform interpretation cannot be guaranteed.

Removing the elements that are unnecessarily restrictive from a tax law perspective from the definitions in Article 2 of the Merger Directive may affect the legal perfection of these operations and carries the risk that the tax relief offered becomes a damp squid, as it would cover operations that cannot be effected under corporate law.

Whereas the definitions in Article 2 of the Merger Directive contain certain elements that are unnecessarily restrictive from a tax law perspective, the Merger Directive also excludes, in some cases, operations that are legally possible under corporate law.

Accordingly, in some cases, it is not possible to do under corporate law what is facilitated (or should be fiscally facilitated) under the Merger Directive. In other cases, it is not always possible under the Merger Directive to do what is possible under corporate law. Three options are proposed to bridge this gap.

The first option is to pursue an own route in the Merger Directive, that is, separate from corporate law. If the requirements in Article 2 of the Merger Directive are met, a taxpayer is

entitled to the tax benefits of the Merger Directive and the unnecessarily restrictive elements from a tax law perspective are removed. A disadvantage of this option is that tax relief may be offered for operations that cannot be effected under corporate law.

The second option is to align the scope of the Merger Directive with the possibilities under corporate law. This avoids ‘dead letters’ and false expectations. A drawback of this option is that the Merger Directive should be amended each time corporate law possibilities are expanded or reduced. Under this option, restructuring operations that are only possible under the corporate laws of certain Member States would not be covered by Article 2 of the Merger Directive as this would not fit within the design of the Merger Directive to provide a “common tax system” instead of an extension at EU level of the systems in force in the Member States. To circumvent having to amend the Merger Directive continuously in order to follow suit with developments under corporate law, it is also possible to require the legal perfection of an operation as a condition for relief under the Merger Directive. This mechanism enables taxpayers to fully utilise the possibilities available to them under corporate law, without standing a chance of ending outside the scope of relevant tax provisions, although a disadvantage is that incompliance with certain relatively trivial corporate law requirements would jeopardise the availability of tax relief.

A joint deficiency of the first two options is the rigidity of listing the qualifying operations, which carries both a risk of overinclusiveness (tax relief is offered for operations that cannot be effected under corporate law) and underinclusiveness (no tax relief is offered for operations that can be effected under corporate law). An unorthodox third option, which does not have this disadvantage, is to replace the definitions of the operations covered by the Merger Directive by a concise “business reorganisations”. For the sake of legal certainty, it may be considered to list the current operations as examples of operations that are covered by the term ‘business reorganisation’.

### 2.3. Chapter 3 – Carry-over of balance-sheet values, provisions, reserves, and losses

#### *Carry-over of balance-sheet values at company level*

The prohibition of taxation in Article 4(1) of the Merger Directive, which is aimed at the Member State of the transferring company, concerns the income taxes levied on the transferring company. As this prohibition only covers ‘capital gains’, the taxation of other items of income remains allowed. In spite of its mandatory wording, Article 4(1) of the Merger Directive does not seem to be opposed to offering the transferring company the choice between immediate payment and deferral. In the end, the receiving company decides whether the transferring company has to pay its tax debt or whether it is entitled to an exemption from immediate taxation.

In spite of the pivotal meaning of the ‘permanent establishment requirement’, the literal meaning of the term ‘permanent establishment’ is not clear and systematic reasoning leads to different interpretations. Given the similarities of the definitions of ‘permanent establishment’ in the other direct tax directives with the definition in Article 5 of the OECD Model Convention, there is support for interpreting the term ‘permanent establishment’ in the Merger Directive in the light

of that definition. In view of the objective of the Merger Directive, it is recommended to abolish the ‘permanent establishment requirement’ and to rely on the ‘taxable income requirement’ only.

In view of the *National Grid* regime, the question arises if the ‘permanent establishment requirement’ is necessary to strike a balance between, on the one hand, removing the tax obstacles to cross-border restructuring, while, on the other hand, safeguarding the taxing rights of the Member State of the transferring company. Four unsatisfactory elements are identified in the *National Grid* regime that have the effect that cross-border restructuring operations and domestic restructuring operations are left at an unequal footing. In the first place, it is not clear when capital gains are realised in the ECJ’s view. In the second place, the ECJ held that the Member State of arrival is not required to give a step-up in basis for the assets and liabilities ‘arriving’ in that Member State. As a result, effectively the same capital gain may be taxed in two Member States and decreases in value that occur after the restructuring operation may not be taken into account. In the third place, the ECJ has accepted that the Member State of departure charges interest on the outstanding tax debt. In the fourth place, the ECJ allowed the Member State of departure to require the provision of a bank guarantee, albeit that the ECJ held in its *DMC* decision that the requirement of a bank guarantee can only be imposed “on the basis of the actual risk of non-recovery of the tax”.

Comparing the two regimes, it appears that the regime in the Merger Directive enables capital gains to be taxed when they are actually realised (*i.e.*, the capital gain is not ‘fixed’) and subsequent decreases in value to be taken into account in the Member State of the transferring company, without the need for interest to be charged or bank guarantees being demanded. On these points, the regime in the Merger Directive is more favourable than the *National Grid* regime, although the absence in the Merger Directive of valuation rules directed at the Member State of the receiving company still does not fully preclude double taxation from arising. In view of the Merger Directive’s aim of creating a common tax system, three options are addressed for designing a tax regime for cross-border restructuring operations in which the Member State of the transferring company loses its right to tax the capital gains incorporated in the transferred assets and liabilities. In the first place, the requirements in Articles 4(2)(b) and 4(4) of the Merger Directive could be abolished with the effect that Article 4(1) of the Merger Directive would always oblige the Member State of the transferring company to refrain from taxing the capital gains arising upon the restructuring operation, regardless whether or not future taxation is safeguarded by that Member State. In the second place, it could be considered to replace the regime in Article 4 of the Merger Directive by a new measure that would remove the tax disadvantages concerning the taxation of all the assets and liabilities of the transferring company, while still safeguarding that Member State’s taxing rights. In the third place, and this option seems to be the most realistic, it is proposed to leave the current regime of Article 4 of the Merger Directive in place for those cross-border restructuring operations that result in the Member State of the transferring company retaining its right to tax the capital gains incorporated in the transferred assets and liabilities, while a suggestion is made to codify the *National Grid* regime for those cross-border restructuring operations that result in the Member State of the transferring company not retaining the right to tax the capital gains incorporated in the transferred assets and liabilities. It should be specified that a capital gain is (deemed to be) realised if the relevant assets and liabilities are alienated or if the hidden reserves are realised through depreciation, albeit that depreciation would only lead to realisation if the receiving

company is in a profit-making position and the depreciation leads to existing capital gains being realised. For the purposes of administrability, taxpayers should also have the option to pay the tax debt in a period of five years. Furthermore, it should be specified that the Member State of the receiving company grants a step-up in basis to real values to avoid double taxation and to enable that Member State to take account of subsequent decreases in value. In addition, the charging of interest should be allowed, although this should be made subject to two conditions. The first condition is that the interest rate reflects the economic cost borne by the Member State of the transferring company for pre-financing the tax debt, but not more than that (charging a higher interest rate is disproportional). The second condition is that the interest does not have to be paid annually, but instead, may be accrued. Finally, the exit tax regime in the Merger Directive should be devoid of a 'bank guarantee requirement'.

The Merger Directive does not provide any guidance as to the allocation of the transferred assets and liabilities to the permanent establishment and the subsequent attribution of profits. As a result, double taxation or double non-taxation may arise. In view of the proposal to make carry-over relief dependent on the existence of a permanent establishment within the meaning of Article 5 of the OECD Model Convention, Article 4 of the Merger Directive should explicitly refer to the guidance by the OECD in allocating assets and liabilities to a permanent establishment and attributing profits to that permanent establishment. Should 'conflicts of allocation' or 'conflicts of attribution' remain, they should be solved by the Member State of the receiving company, who should follow the allocation and attribution by the Member State of the transferring company.

It is possible that the Member State of the transferring company restrictively defines or allocates its taxing rights in order to forego having to grant carry-over relief. With a view to legal certainty, in line with the other directives in the field of taxation, it could be considered to require that, in situations within the ambit of Article 5 of the OECD Model Convention, carry-over relief would always have to be available. This would trigger Member States to ensure that the term 'permanent establishment' under its domestic law and under the tax treaties that it has concluded is equal to Article 5 of the OECD Model Convention. As a strong incentive for Member States to align their taxing rights in such a way, it could be considered to add to the 'taxable income requirement' in Article 4(2)(b) of the Merger Directive a reference to Article 5 of the OECD Model Convention. The Member State of the transferring company would then have to grant carry-over relief if either a permanent establishment within the meaning of Article 5 of the OECD Model Convention remains behind or the assets and liabilities continue to generate taxable income. It could also be stated in the Merger Directive that the Member State of the receiving company is obliged to value the assets and liabilities that do not constitute a permanent establishment within the meaning of the applicable tax treaty, but that do constitute a permanent establishment within the meaning of Article 5 of the OECD Model Convention, at their values for tax purposes in the hands of the transferring company. This solution ensures that the gain incorporated in the transferred assets and liabilities can at least be taxed once, namely, in the Member State of the receiving company.

Pursuant to the second subparagraph of Article 10 of the Merger Directive, the Member State of the transferring company is allowed to reinstate the non-recovered losses of the permanent establishment that were offset against taxable profits in the Member State of the transferring

company. It is argued that the ECJ's decision in *Nordea Bank* implies that the amount of the reinstatement should not exceed the amount of hidden reserves incorporated in the transferred assets and liabilities. Furthermore, as less restrictive alternatives exist to attain the objective of guaranteeing the coherence of the tax system, it is contended that the non-recovered losses of the permanent establishment cannot be reinstated immediately. Although Article 10 of the Merger Directive does not cover the transfer of a subsidiary, it is put forward that this does not give rise to a breach of the freedom of establishment (neutrality of legal form) since, concerning the taxation of capital gains, there is a difference between (the transfer of) a permanent establishment and (the transfer of shares in) a subsidiary, in view of the allocation of taxing powers.

#### *Carry-over of balance-sheet values at shareholder level*

Concerning the carry-over of balance-sheet values at shareholder level, it is concluded that Article 8 of the Merger Directive is only aimed at the shareholders of the transferring or acquired company, although the issue of 'new' securities by the receiving or acquiring company may lead to the 'watering down' of an existing shareholder's interest in those companies and, therefore, trigger the taxation of the income, profits or capital gains of the existing shareholder (for instance, because the applicable regime changes). It is recommended to expand the scope of Article 8 of the Merger Directive in order to cover the shareholders in the receiving or acquiring company as well or, in the case of a 'triangular merger', the company issuing the securities.

Article 8(1) of the Merger Directive does not specify *which* taxes may not be levied. As the term 'shareholder' covers both corporations and individuals, also the tax benefits cover corporation taxes and personal taxes.

As a main rule, the Member State of the shareholder will be allowed to tax the gain arising with the cancellation of securities and/or the issue of new securities. A carry-over of balance-sheet values is suitable to defer taxation and safeguard the taxing rights of the Member State of the shareholder, unless the applicable regime changes (see Article 8(6) of the Merger Directive) or the shareholder holds a shareholding in an 'immovable property company'. If the scope of Article 8(1) of the Merger Directive is expanded to cover also the (non-)taxation of the shareholders in the receiving or acquiring company, the 'claim savers' in Articles 8(4) and 8(5) of the Merger Directive, which require a shareholder not attributing to the securities received values for tax purposes higher than the securities had immediately before the restructuring operation, are not suitable.

If the Member State of the shareholding taxes the shareholder – which it will not be allowed to do if the tax treaty between the Member State of the shareholder and the Member State of the shareholding is drafted along the lines of the OECD Model Convention (unless the shareholding is an immovable property company) and in any event it should respect the fundamental freedoms when taxing the shareholder – the question arises whether or not Article 8 of the Merger Directive is equipped to defer taxation without a loss of that Member State's taxing rights. It is concluded that the Member State of the shareholding loses its taxing rights if the receiving company is resident in another Member State than the transferring company, in spite of the shareholder valuing the securities received at the same values that the securities exchanged had

immediately before the restructuring operation. And even if the shareholding is not dissolved, the Member State of the shareholding may still lose the taxing rights that it had prior to the exchange of shares. A ‘taxation leak’ – the Member State of the shareholding has to refrain from taxation, while future taxation is not safeguarded – does not tally well with the scheme and the objective of the Merger Directive and it is not clear whether the EU legislator was aware of this ‘taxation leak’, whether Article 8 of the Merger Directive was simply drafted inadequately or whether it was purposely decided to safeguard only the taxing rights of the Member State of the shareholder and not those of the Member State of the shareholding, in line with Article 13(5) of the OECD Model Convention.

A restructuring operation may trigger a change of the regime applicable to the shareholding. Article 8(6) of the Merger Directive, which allows Member States to tax the gain arising out of the securities received in the same way as the gain arising out of the securities exchanged, should be interpreted as allowing only the taxation of the ‘apportioned’ capital gain, that is, the gain incorporated in the shareholding at the time of the restructuring operation. This way, the risk of treaty override can also be averted.

The current ‘claim savers’ in Article 8 of the Merger Directive are inadequate to safeguard taxing rights if no securities are exchanged, but rather, the shareholdings by the existing shareholders are ‘watered down’. Furthermore, these ‘claim savers’ fail to safeguard the taxing rights of the Member State of the shareholding. In addition, recourse should be had to a specific provision (Article 8(6) of the Merger Directive) if the regime that is applicable to the shareholding changes. The root cause of the loss of taxing rights is that a certain valuation of its securities by a shareholder does not necessarily guarantee future taxation by the Member States concerned. It is, therefore, recommended to complement the generic and specific ‘claim savers’ in Article 8 of the Merger Directive with a ‘taxable income requirement’. If that requirement is not met, Member States should be allowed to tax the income, profits or capital gains incorporated in the securities at the time of the restructuring operation, albeit that such taxation has to be proportional.

#### *Carry-over of provisions or reserves*

The term ‘provisions or reserves’ is not defined in Article 5 of the Merger Directive. Pursuant to the view of the Council and the Commission it encompasses all facilities that entail a decrease of currently taxable profits and, when recovered, give rise to an increase of future taxable profits. In that view, the term provisions or reserves only covers deferred tax liabilities, and not deferred tax assets as well, although its wording would not be opposed to such a broad meaning.

No carry-over relief is available for provisions or reserves that are derived from permanent establishments abroad. Typically, however, if provisions or reserves are derived from permanent establishments abroad, they will also be attributable to those permanent establishments. In those cases, Article 10(1), third subparagraph, of the Merger Directive requires the Member State in which the permanent establishment of the transferring company is situated to carry-over the provisions or reserves to the (future) permanent establishment of the receiving company. If, however, provisions or reserves are constituted at head office level, while they relate to assets and liabilities at permanent establishment level, it can be inferred from ECJ decisions such as

*Laboratoires Fournier* and *Argenta* that a Member State would not be allowed to recapture such provisions or reserves if they would not have been recaptured if they were derived from domestic permanent establishments.

#### *Takeover of losses*

Since Article 6 of the Merger Directive, which governs the takeover of losses, also covers operations in which the transferring company is not dissolved, it is argued that the purpose of Article 6 of the Merger Directive is to prevent the losses of the transferring company from becoming forfeited in the case of a cross-border restructuring operation.

In common parlance, Article 6 of the Merger Directive does not cover the carry-over of other deferred tax assets than ‘losses’, and it would exclude, for example, unused foreign tax credits. A recommendation is made to stretch the scope of Article 6 of the Merger Directive to cover all types of deferred tax assets that are possibly forfeited in the case of a restructuring operation. Simultaneously, the scope of Article 5 of the Merger Directive should be expanded to cover all types of deferred tax liabilities. Instead of listing specific types of deferred tax assets and liabilities, it is suggested to use broader terms, such as ‘non-exhausted tax relief’ and ‘recoverable tax relief’. An additional step would be to complement Articles 5 and 6 of the Merger Directive with a general provision that reflects the fiscal subrogation by the (permanent establishment of the) receiving company of the transferring company’s fiscal position and its rights and obligations.

Article 6 of the Merger Directive only covers the takeover of the losses of the transferring company. It fails to reflect that also the issue of securities could result in the forfeiture of the losses of the receiving company for triggering a ‘change of ownership’. The same applies to the acquiring and acquired company in an exchange of shares, a restructuring operation that seems to be neglected by Article 6 of the Merger Directive. It is recommended that Article 6 of the Merger Directive stipulates that a restructuring operation does not lead to the forfeiture of the losses of the receiving, acquiring or acquired company as well.

Unlike Article 13(2) of the Merger Directive, which governs the takeover of losses in the case of the transfer of the registered office of an SE or an SCE, Article 6 of the Merger Directive does not provide for a carry-back of losses. It is recommended that a one-year carry-back of losses be possible ‘domestically’, that is, within the Member State of the transferring company. If a loss incurred in the Member State of the receiving company can still be carried forward, a cross-border carry-back of losses (*i.e.*, from the Member State of the receiving company to the Member State of the transferring company) does not have to be allowed as the Member State of the transferring company is not obliged to take account of foreign losses that are not yet ‘final’.

Article 6 of the Merger Directive only requires a takeover of losses to the extent that the Member State of the transferring company would have allowed this if the operations were effected between companies from that Member State. It is recommended that Article 6 of the Merger Directive unconditionally allows losses to be taken over in a cross-border restructuring operation. This would especially hold true for mergers and divisions as for those restructuring operations, losses that cannot be taken over, become forfeited. But it should also be possible in

the case of a partial division or a transfer of assets for the receiving company to take over those losses of the transferring company that relate to the transferred assets and liabilities, even though with these restructuring operations the transferring company is not dissolved and these losses could, therefore, also have remained with the transferring company.

The Merger Directive fails to clarify which part (or perhaps all) of the losses of the transferring company should be apportioned to the assets and liabilities that become connected with a permanent establishment, if only part of the transferring company's assets and liabilities become connected with a permanent establishment of the receiving company in the Member State of the transferring company.

In analysing the question of apportionment of losses to transferred assets and liabilities, a distinction should be drawn between (i) mergers and divisions, which result in the dissolution of the transferring company/-ies and (ii) partial divisions and transfers of assets, which do not result in the dissolution of the transferring company.

In the case of a merger or a division, if all the transferred assets and liabilities remain behind in a taxable permanent establishment, all the losses should be apportioned to the transferred assets and liabilities. Similarly, if none of the transferred assets and liabilities remain behind in a taxable permanent establishment, the losses can no longer be offset in the Member State of the transferring company and it should be possible to take those losses into account in the Member State of the receiving company as 'final' losses. If only part of the transferring company's assets and liabilities become connected with a permanent establishment of the receiving company in the Member State of the transferring company, while the other part of the transferring company's assets and liabilities are transferred to the Member State of the receiving company, all the losses should be apportioned to the transferred assets and liabilities remaining behind in a taxable permanent establishment, as the Member State of the receiving company should not be required to accept losses of the transferring company while a taxable permanent establishment remains behind in the Member State of the transferring company.

By contrast, in the case of a partial division or a transfer of assets, the transferring company is not dissolved and, as the right to carry-forward losses should be regarded as a subjective right of the transferring company, the main rule should be that the transferring company's losses remain with the transferring company. If, however, the taxpayer can demonstrate that part of the losses relate to the transferred assets and liabilities that become effectively connected with a permanent establishment in the Member State of the transferring company, those losses should be apportioned to those transferred assets and liabilities. It is submitted that if the assets and liabilities that are transferred with a partial division or a transfer of assets do not become effectively connected with a permanent establishment of the receiving company in the Member State of the transferring company, the Member State of the receiving company will not be prepared to take the losses that relate to the transferred assets and liabilities into account as 'final' losses, as the losses can remain behind with the transferring company.

The losses of the transferring company could be apportioned to the transferred assets and liabilities in proportion to the factors of sales, labour and assets in the transferred assets and liabilities are in relation to the sales, labour and assets in the transferring company.



Article 6 of the Merger Directive does not specify against which profits of the receiving company the losses of the transferring company can be offset, but, as the possibility to take over losses should be aimed at maintain the *status quo*, a 'ringfencing of profits' seems a sensible solution to prevent restructuring operations from facilitating the transferring company's losses being offset against another company's profits, something which would not have been possible without the restructuring operation. Even if also applied 'domestically', a 'ringfencing of profits' carries the disadvantage in the case of a cross-border restructuring operation that the Member State of the receiving company will only have to allow the losses of the transferring company to be taken into account if they are 'final'. A 'ringfencing of profits' would effectively prevent foreign 'final' losses from being taken into account, since these losses typically do not relate to profit-generating activities. It is, therefore, suggested that 'final' losses of the transferring company can be set off against all profits of the receiving company in the Member State of the receiving company.

Although Article 6 of the Merger Directive only covers a domestic takeover of losses, it became clear in the *A Oy* decision that it would be contrary to the freedom of establishment if the Member State of the receiving company would disallow the cross-border takeover of 'final' losses incurred in the Member State of the transferring company. The ECJ has recognised the limited taxing powers of the source Member State (the Member State of the transferring company) by not compelling that Member State to take into account residence Member State-losses (the Member State of the receiving company). So far, the ECJ has made a different choice when it concerns the position of the residence Member State: even if this Member State does not have any domestic taxing rights to tax the foreign-sourced positive income, or it has waived those domestic taxing rights under the applicable tax treaty, the residence Member State could still be required to accept the deduction of source Member State-losses.

On the point of 'final' losses, one should distinguish between the situations covered by the *Marks & Spencer* decision and the situations covered by the *A Oy* decision. The *Marks & Spencer* decision is of relevance for situations where a transfer of losses would have been possible domestically through group consolidation / relief / contribution, but not in a cross-border situation. As, domestically, losses are offset on a current basis, it becomes necessary to identify when the losses are 'final' in the source Member State in order to determine when those losses can be taken into account in the residence Member State. In the *X Holding* decision it became clear that Member States are not obliged to take into account losses of a foreign subsidiary on a current basis. Hence, only 'final' losses of that subsidiary can be taken into account. A relevant question here is whether the possibilities to take the losses into account in the source Member State must have been exhausted legally or (also) factually. Legal exhaustion occurs, for example, upon the expiry of the term during which losses can be carried forward, while factual exhaustion arises when, for instance, the subsidiary is liquidated and its activities discontinued. Subsequently, if the losses can be regarded as 'final', it has to be determined which amount of losses can be taken into account in the residence Member State.

Where the restructuring operation results in the dissolution of the transferring company, which is the case with a merger or a division, and no permanent establishment remains behind, its losses

can by definition no longer be used in the Member State of the transferring company and those should, therefore, be regarded as ‘final’. Where the restructuring operation does not result in the dissolution of the transferring company, which is the case with a partial division or a transfer of assets, the losses of the transferring company that relate to the assets and liabilities that are transferred to the Member State of the receiving company should remain behind with the transferring company and those losses should, therefore, not be regarded as ‘final’.

Having found that losses have become ‘final’, it has to be determined which amount of the losses of the transferring company can be taken into account in the Member State of the receiving company. Losses that were never deductible in the Member State of the transferring company cannot be regarded as ‘final’ losses. If losses have been deductible in the Member State of the transferring company, it should be determined according to the rules in the Member State of the receiving company if, and for what amount, these losses are ‘final’.

In spite of the broader possibilities for loss relief emerging from the *A Oy* decision, Article 6 of the Merger Directive should not be considered to be in breach of the Merger Directive. In the *Gaz de France* decision, it became clear that the ECJ attaches great importance to the EU institutions’ powers to introduce harmonisation in stages as this is already difficult enough in the field of direct taxation. It is more realistic to view the absence of cross-border loss relief in Article 6 of the Merger Directive as inherent to a gradual process of harmonisation rather than a consciously discriminatory choice that is incompatible with higher EU law.

An expansion of Article 6 of the Merger Directive would nevertheless align with the preamble to the Merger Directive, in which an extension, at EU level, of the systems in force in the Member States is dismissed, since differences between these systems can produce distortions. These distortions occur at present, for instance, because certain Member States allow a receiving company to take over losses in a domestic restructuring operation, while others do not, and only those Member States that allow this for a domestic restructuring operation also have to permit it in a cross-border situation. The *A Oy* decision leaves a number of unresolved issues in place in respect of cross-border loss relief, for example, when losses should be regarded as ‘final’ or how ‘final’ losses are to be calculated. Based on the above analyses, a proposal is made for an expanded and improved Article 6 of the Merger Directive.

### *Hybrid entities*

It is reviewed if, and to what extent, the objectives of the Merger Directive are attained if (any of) the companies involved in the restructuring operation are hybrid entities. The examples discussed demonstrate that the specific rules in the Merger Directive addressing hybrid entities are complex and in some cases superfluous. The ‘opting out’ rules in Article 11 of the Merger Directive make the regime applicable to hybrid entities less favourable than the regime applicable to normal companies. Three options are proffered to achieve a level playing for cross-border restructuring operations involving hybrid entities: (i) do nothing and leave it to the Member States to apply the general provisions of the Merger Directive in conformity with the free movement provisions, (ii) insert provisions that deal specifically with hybrid situations, or (iii) require Member States to follow the classification by the Member State of residence of the hybrid entity.

### *‘Valuation rules’*

In spite of various ‘valuation rules’, the Merger Directives also contains several ‘valuation gaps’, meaning that the Merger Directive may require the valuation at a carried-over balance-sheet values at one level, but leaves the valuation at another level to the Member State(s) concerned. This potentially fosters the double taxation of the same capital gain .

For example, although carry-over relief in the case of a transfer of assets is made conditional upon the receiving company continuing with the balance-sheet values of the transferred assets and liabilities, the Merger Directive does not contain any rules for the valuation of the securities received by the transferring company. Consequently, double taxation may arise if the transferring company would be obliged to value the securities received at the same values that the transferred assets and liabilities had. A recommendation is made to insert in Article 9 of the Merger Directive that the securities received shall have attributed to them the real values that the assets and liabilities had immediately before the transfer. If the Member State of the transferring company would indeed safeguard its taxing rights in two different ways (by requiring both the securities received and the transferred assets and liabilities to be valued at their balance-sheet values) it is an interesting (open) question if the transferred assets and liabilities can be disposed of without taxation after the transfer of assets, as the Member State of the transferring company retains its claim on the securities received.

The ‘subrogation requirement’ in Article 4(4) of the Merger Directive addresses the valuation of the transferred assets and liabilities in the Member State of the transferring company, but does not touch upon their valuation in the Member State of the receiving company. This can give rise to double taxation of effectively the same capital gain in two Member States if the receiving company disposes of the transferred assets and liabilities after the restructuring operation. To resolve such double taxation and to ensure that decreases in value after the restructuring operation can be taken into account, the Member State of the receiving company should be required to value the assets and liabilities received at their real values.

Although, in the case of an exchange of shares, Articles 8 of the Merger Directive contains a rule directed at the Member State of the shareholder, it is silent on the valuation by the acquiring company of the securities received in the acquired company. As a result, if the acquiring company would be required to value the securities received at the values that those securities had in the hands of the shareholder, effectively the same capital gain would be taxed twice. As a remedy, the acquired company in an exchange of shares should attribute to the securities received the real values of the securities issued to the shareholders of the acquired company. To prevent that the transfer of own securities results in a permanent loss of taxing rights if the acquisition costs of those own securities is lower than the real values of the securities at the time of the exchange, Member States should be allowed to compute any income, profits or capital gains, from the subsequent transfer of the securities received, according to the values those transferred shares had immediately before the exchange.

## 2.4. Chapter 4 – The combat of tax avoidance under the Merger Directive

### *The combat of tax avoidance under Article 15(1)(a) of the Merger Directive*

The first component of Article 15(1)(a) of the Merger Directive is the option to refuse to apply or withdraw the benefit of the Merger Directive if an operation has as its principal objective or as one of its principal objectives tax avoidance. The second component is a presumption of guilt: the fact that an operation is not carried out for valid commercial reasons may imply that the operation has tax avoidance as its principal objective or as one of its principal objectives. Absent valid commercial reasons, there is only the presumption of guilt, which can be refuted by the taxpayer. A ‘valid commercial reason’ is, therefore, not necessary *per se* to qualify for the Merger Directive’s benefits. What matters, is that the restructuring operation does not have as its principal objective or as one of its principal objectives tax avoidance.

Although tax avoidance is presumed in the absence of valid commercial reasons, Article 15(1)(a) of the Merger Directive is silent on the division of the onus of proof between the taxpayer and the tax inspector if valid commercial reasons exist. This implies, in the present author’s view, that the division of the onus of proof is part of the procedural autonomy of the Member States, in line with settled case-law of the ECJ.

The use of the word “may” suggests that the combat of tax avoidance under the Merger Directive is voluntary, which ties in with case-law in which the ECJ held that there is no obligation to combat tax avoidance in the field of direct taxation.

The term ‘valid commercial reasons’ is not defined in the Merger Directive, although an example is provided: “the restructuring or rationalisation of the activities of the companies participating in the operation”. In the *Foggia* decision, the ECJ clarified that the concept of ‘valid commercial reasons’ “involves more than the attainment of a purely fiscal advantage”. Furthermore, according to the ECJ: “a merger operation based on several objectives, which may also include tax considerations, can constitute a valid commercial reason provided, however, that those considerations are not predominant in the context of the proposed restructuring.” Benefits that are inherent in any restructuring operation do not automatically constitute valid commercial reasons”

It is not clear whether refusing to apply or withdraw the benefits of the Merger Directive is all that a Member State is allowed to do in order to avert tax avoidance. In the *A.T.* decision, the ECJ held that Member States are not allowed to make the Merger Directive’s benefits dependent on additional conditions and it stressed that a refusal of the benefits of the Merger Directive is only expedient in the case of tax avoidance. In the *3D I Srl* decision, the ECJ added an important nuance by distinguishing between additional conditions that cause a disadvantage *at the time of the restructuring operation*, and those that cause a disadvantage *at a later stage*. Only the former additional conditions are prohibited under the Merger Directive. In contrast with the *A.T.* decision, in which additional *material* requirements applied (a ‘double book value carryover requirement’), the ECJ held in the *Pelati* decision that additional *procedural* requirements are outside the straitjacket of Article 15(1)(a) of the Merger Directive. Such requirements are allowed if they comply with the EU law principles of equivalence and effectiveness. This is disappointing, in the present author’s view, as the working of the Merger Directive can be frustrated by meaningless procedural requirements, provided that they are sufficiently clear and foreseeable, apply non-discriminatorily and do not make it “excessively difficult” for the taxpayer to exercise the rights derived from the Merger Directive. The respect for the procedural

autonomy of the Member States within the ambit of the Merger Directive leaves a diversity of procedural rules in place, which does not tally with the aim of providing a “common tax system”.

*Framework for the interpretation of Article 15(1)(a) of the Merger Directive*

The reasons for an operation are not relevant in determining whether a certain operation falls within the scope of the Merger Directive, but they become important in giving effect to the anti-avoidance provision. Systematically, it is, therefore, consistent if Articles 1 – 14 of the Merger Directive are devoid of anti-avoidance elements and the combat of tax avoidance is confined to Article 15(1)(a) of the Merger Directive. Considering that the scope of the Merger Directive is limited, both as regards the tax benefits (it only contains tax benefits – a deferral of taxation – at the time of the restructuring operation) and as regards the taxes covered, the anti-avoidance provision cannot be aimed at countering adverse tax consequences that occur at a later stage than the restructuring operation itself nor can it serve to ward off the avoidance of taxes that are not covered by the Merger Directive.

In view of the Merger Directive’s aim of safeguarding the financial interests of the Member States, the question arises if the benefits of the Merger Directive can be refused if a restructuring operation results in a reduction of the taxing rights of the Member States. Or, conversely, should the benefits of the Merger Directive always be granted if taxing rights are safeguarded? Given the specific ‘claim savers’ in place in Articles 1 – 14 of the Merger Directive, if the role of Article 15(1)(a) of the Merger Directive were to be reduced to that of a ‘claim saver’ as well, this would not only transform this provision into a paper tiger in situations in which taxing rights are safeguarded, it would also give display of an insufficient recognition of the scheme of the Merger Directive. If the Merger Directive’s purpose would be refined to facilitating only cross-border restructuring operations that contribute substantially to the effective functioning of the internal market, the effect would be that, in spite of taxing rights being safeguarded, the benefits of the Merger Directive should be refused if a restructuring operation does not make such a substantial contribution. In the present author’s view, however, such a restrictive reading should be dismissed as it is an arbitrary judgment whether or not a certain restructuring operation contributes to the effective functioning of the internal market. As the ECJ has been lenient in concluding access to the Merger Directive, companies will almost always be considered to contribute to the internal market if one takes the step that access to the freedom of establishment necessarily implies a contribution to the internal market. Furthermore, the notion that the Merger Directive’s benefits should be widely available is supported by the ‘light’ criteria for qualification as a ‘company from a Member State’ in Article 3 of the Merger Directive.

In the *Kofoed* decision the ECJ held that Article 15(1)(a) of the Merger Directive “reflects the general Community law principle that abuse of rights is prohibited.” The relationship between the two is that of a *lex specialis* to a *lex generalis*, which implies that the anti-avoidance provision in the Merger Directive exhaustively determines in which circumstances the benefits of the Merger Directive can be refused. It is only proportional to refuse the tax benefits of the Merger Directive on the grounds of combating tax avoidance if both an objective and a subjective test are fulfilled. Both tests can be read into Article 15(1)(a) of the Merger Directive. Whereas in the light of the purpose of the freedom of establishment, the objective test is fulfilled in case of a ‘wholly artificial arrangement’ (no actual establishment to pursue a genuine

economic activity), these norms should not necessarily be transposed to the Merger Directive if its purpose is construed broadly as removing the tax disadvantages to cross-border restructuring operations, while safeguarding taxing rights.

In its case-law, the ECJ has emphasised the role of the principle of proportionality in the interpretation of the anti-avoidance provision in the Merger Directive. This principle influences the design of anti-avoidance provisions in the Merger Directive and the application thereof. The notion that a provision should not go beyond what is necessary to attain the objective of tax avoidance translates as: anti-avoidance measures should enable the determination of tax avoidance on a specific, case-by-case basis. In general, blunt provisions are out of the question. It is also disproportional if a rule is “made subject to the mere possibility of the grant of a derogation, at the discretion of the administrative authority.”<sup>901</sup> The principle of proportionality not only curbs the finding of tax avoidance by the tax authorities, but also their sanctioning. In the sanctioning of tax avoidance, the measure taken should be suitable to combat tax avoidance and not go beyond what is necessary to achieve that aim. A refusal of the benefits at *company* level, for instance, is not suitable to prevent tax avoidance at *shareholder* level (or *vice versa*) and neither is the refusal of domestic tax benefits appropriate to forestall the avoidance of foreign taxes.

With the *Kofoed* decision in mind, the relevance of the principle of legal certainty seems two-fold. In the first place, it is almost self-evident that a provision, be it a directive provision or a provision of domestic law, should create a legal situation that is sufficiently precise and clear. In the second place, the principle of legal certainty precludes Member States from relying on the general EU law principle that abuse of rights is prohibited as an *ultimum remedium* in cases in which they do not have any “general legal context” in place that can be interpreted in a directive-compliant manner.

#### *Framework for the interpretation of Article 15(1)(a) of the Merger Directive*

To contemplate how tax avoidance should be combated under the Merger Directive without knowing exactly which types of tax avoidance possibly exist, seems as pointless as choosing a hunting rifle without knowing what game to hunt. For illustrational purposes, several possible types of tax avoidance are identified and discussed.

By converting, under the Merger Directive’s carry-over facilities, an immediately taxable gain to a gain that is taxable in the future, taxation can be deferred. Tax authorities may want to combat these ‘deferral structures’ and the expediency to depends on the interpretation of the Merger Directive’s purpose. A broad reading (the Merger Directive’s facilities should always be available as long as taxing rights are safeguarded) is clearly favourable towards ‘deferral structures’, whereas a narrow reading (the restructuring operation should also contribute substantially to the effective functioning of the internal market), which was dismissed, provides more ammunition for a challenge on the basis of the anti-avoidance provision. If one takes a narrow purposive reasoning, however, it is also necessary to apply the principle of

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<sup>901</sup> Case C-310/95, *A. Leur-Bloem v Inspecteur der Belastingdienst / Ondernemingen Amsterdam* [17 July 1997] ECR I-04161 (paragraph 44).

proportionality, which entails that 'deferral structures' cannot be regarded as tax avoidant *per se*. In examining whether or not a restructuring operation that implies the conversion of an immediately taxable gain to a deferred gain has tax avoidance as its principal objective or as one of its principal objectives, relevant questions are: (i) was the disposal of the securities in the receiving or acquiring company part of the step plan, or did this come unexpectedly, (ii) were there valid commercial reasons for the restructuring operation, and (iii) were the transactions carried out intra-group or with third parties?

In spite of the various 'claim savers' to ensure that the obligation to refrain from taxation at the time of the restructuring operation does not imply a permanent loss of taxing rights, lacunae remain. A loss of taxing rights will only constitute tax avoidance if this is contrary to the purpose of the provision concerned. With so many specific 'claim savers' in place, it would be difficult to maintain that a general anti-avoidance provision, in lieu of a specific 'claim saver', would be the most logical entry to forestall a loss of taxing rights. Although safeguarding the Member States' financial interests is one of the Merger Directive's stated objectives, and a loss of taxing rights would, therefore be contrary to that objective, it should be viewed as inevitable when challenging the loss of taxing rights pursuant to Article 15(1)(a) of the Merger Directive would run counter to the Merger Directive's scheme. A restructuring operation that has a loss of taxing rights as its principal objective or as one of its principal objectives would be more prone to constitute tax avoidance than a restructuring operation that is commercially induced and that has a loss of taxing rights merely as a corollary.

Several situations involving the compensation of the transferring company's losses with the receiving company's profits were identified that may possibly be regarded as undesirable. Solutions include, in the case of a partial division or a transfer of assets, setting as a main rule that the losses of the transferring company remain with the transferring company, unless the taxpayer can demonstrate that part of the losses that relate to the transferred assets and liabilities become effectively connected with a permanent establishment in the Member State of the transferring company, in which case those losses should be apportioned to those transferred assets and liabilities. The possibly undesirable compensation of the losses of the transferring company against profits realised by the receiving company in the Member State of the transferring company through an already existing permanent establishment (hence, with profits that do not relate to the transferred assets and liabilities) can be curbed by a 'ringfencing of profits'. 'General' circumstances, such as the fact that the loss-making transferring company does not carry on activity and does not contribute assets to the receiving company, do not automatically indicate that the restructuring operation is not carried out for valid commercial reasons; the presence of a tax avoidant motive has to be examined on a case-by-case basis.

A restructuring operation may have no other objective than the obtainment of a tax benefit after the restructuring operation. In view of the *3D I Srl* decision, it is clear that the Merger Directive has a limited scope and if the term 'avoidance of taxation' is interpreted in the light of this limited scope, it necessarily only covers the avoidance of the immediate taxation for which the provisions in the Merger Directive offer relief. This means that in situations in which a tax benefit is derived after the restructuring operation, no tax avoidance takes place. Hence, in those situations, the benefits of the Merger Directive cannot be refused.

The broad term ‘avoidance of taxation’ literally suggests that the reduction of any taxing rights could potentially justify the refusal of the Merger Directive’s benefits. In the *Zwijnenburg* decision, however, the ECJ clarified that the anti-avoidance provision only allows a refusal of the Merger Directive’s benefits if the taxes covered by those benefits are at stake. In the present author’s view, as the basis and rate of withholding taxes on profit distributions differ from income taxes and they have different characteristics, a loss of withholding taxing rights cannot be averted by refusing the benefits of the Merger Directive. This would be unsuitable, and also go beyond what is necessary, to safeguard the right to levy the withholding tax.

*(How) should the Merger Directive be amended?*

It should be clarified in the preamble whether the Merger Directive covers any restructuring operation, as long as ultimate taxation is safeguarded, or whether only those restructuring operations are covered that contribute substantially to the functioning of the internal market. In the present author’s view, the Merger Directive is designed to remove the tax disadvantages to commercially desirable restructuring operations and it should not be a catalyst to performing restructuring operations solely to obtain a tax advantage. This means that a restructuring operation that has as its principal objective or as one of its principal objectives the conversion of a taxable gain to a deferred gain should not be entitled to the benefits of the Merger Directive. If securities are disposed of after the restructuring operation and it can not only be established that the restructuring operation has as its principal objective or as one of its principal objectives the conversion of a taxable gain, but also, applying the *Cadbury Schweppes*-criteria, that the restructuring operation has an artificial character (for instance, the disposal of the securities was part of the step plan), the benefits of the Merger Directive (the carry-over relief at the time of the restructuring operation) can retroactively be refused. This would ensure that the Merger Directive facilitates commercially desirable restructuring operations, but not those that are artificial and tax driven.

As it is difficult to challenge a loss of taxing rights through Article 15(1)(a) of the Merger Directive, especially when a loss of taxing rights was merely a corollary and not a principal objective or one of the principal objectives of the restructuring operation, it should be clarified in the preamble in which cases taxing rights should be protected. To avert a loss of taxing rights, the ‘claim savers’ in the Merger Directive can be expanded without the need of designing a tailored anti-avoidance provision.

A possible solution to avert a loss of taxing rights, *e.g.*, in case a restructuring operation leads to the Member State of the shareholding no longer being able to tax a non-resident shareholder, is that, if the ‘new’ shareholder sells its shareholding, the ‘old’ shareholder is taxed on the capital gain that is fixed at the time of the restructuring operation.

To curb restructuring operations that are aimed at the compensation of the losses of the transferring company with the profits of the receiving company in a way that may be considered to be undesirable, the insertion of specific anti-avoidance provisions in Article 6 of the Merger Directive would not fit well within the scheme of the Merger Directive. Relatively straightforward and proportionate solutions to put a halt to certain examples of undesirable compensation of losses are: (i) in the case of a partial division or a transfer of assets, setting as a



main rule that the losses of the transferring company remain with the transferring company, unless the taxpayer can demonstrate that part of the losses that relate to the transferred assets and liabilities become effectively connected with a permanent establishment in the Member State of the transferring company, in which case those losses should be apportioned to those transferred assets and liabilities and (ii) a ‘ringfencing of profits’. In other cases it is desirable, in the present author’s view, to leave the specific, case-by-case examination of tax avoidance to Article 15(1)(a) of the Merger Directive.

As the Merger Directive covers all restructuring operations, regardless of the reasons for those operations, and those reasons are only important in the implementation of the option provided in Article 15(1)(a) of the Merger Directive, it is sensible in the light of the scheme of the Merger Directive that Articles 1 – 14 of the Merger Directive are devoid of anti-avoidance elements, and the challenge of tax avoidance is left to Article 15(1)(a) of the Merger Directive.

## 2.5. Chapter 5 – The avoidance of double taxation under the Merger Directive

### *The 3D I Srl decision*

The *3D I Srl* decision makes clear that where the Merger Directive is silent, a Member State retains discretionary powers to make the directive’s benefits dependent upon additional conditions, unless these conditions give rise to the taxation of capital gains at the time of the restructuring operation. Double taxation arising at a later stage than the restructuring operation is not prevented by the Merger Directive.

### *Conflicts of interpretation concerning the term ‘permanent establishment’*

As the Merger Directive does not contain a definition of the term ‘permanent establishment’, it is conceivable that the Member State of the transferring company and the Member State of the receiving company interpret this term differently. As a result, situations of double taxation and double non-taxation can occur due to conflicts of interpretation. As those situations jeopardise the accomplishment of the objective of the Merger Directive, this is undesirable.

In the present author’s view, conflicts of interpretation concerning the term ‘permanent establishment’ should be distinguished from conflicts of interpretation concerning other terms. Essentially, the interpretation of the term ‘permanent establishment’ in Article 4(2)(b) of the Merger Directive comes down to an interpretation of the term ‘permanent establishment’ in Article 5 of the OECD Model Convention, which has an ambiguous meaning. As the term ‘permanent establishment’ in the Merger Directive embroiders on a concept that already existed for a long time in the domestic laws and the tax treaties of the Member States, it seems a tall order to expect from the ECJ to provide the required clarity, when such clarity does not exist at the level of the Member States or at the level of the OECD. If the ECJ, instead of the OECD, interprets a term that is based on Article 5 of the OECD Model Convention, a risk of diverging interpretations exists. The interpretation by the ECJ of the term ‘permanent establishment’ in one bilateral situation could also affect another bilateral situation, in which no conflict of interpretation exists. By interpreting the term ‘permanent establishment’ in a bilateral situation in which no conflict of interpretation regarding that term exists, the ECJ would cause a rift with its

own settled case-law, in which it has consistently held that Member States remain competent to determine how they allocate taxing powers with a view to eliminating double taxation, provided that they exercise their taxing powers consistently with EU law.

If one Member State would follow the interpretation by the other Member State, there would be no conflict of interpretation that leads to double taxation. As the primacy to determine whether there is a permanent establishment rests with the Member State of the transferring company, it stems from this order that the Member State of the receiving company should follow the interpretation by the Member State of the transferring company. The duty of consistent interpretation under EU law requires the term ‘permanent establishment’ to be interpreted in the light of the purpose of the Merger Directive in order to achieve the result pursued by it, and the interpretation pursuant to which the Member State of the receiving company qualifies the transferred assets and liabilities similarly to the Member State of the transferring company is best suited. Also, if the term ‘permanent establishment’ is interpreted in the light of primary EU law, an interpretation that avoids double taxation is preferable to an interpretation that creates double taxation, given one of the aims of the TFEU to establish an internal market.

There are four possible counter-arguments against the proposed solution. Firstly, the proposed solution hardly contributes to the desired uniformity of EU law. Secondly, it is doubtful whether the duty of consistent interpretation actually goes as far as requiring the Member State of the receiving company to take account of the interpretation by the Member State of the transferring company in order to resolve double taxation, given that it has frequently reiterated that Member States are not required to draw up their tax rules on the basis of those in other Member States in order to remove disparities arising from national tax rules. Thirdly, as many tax treaties rely on a MAP to solve conflicts of interpretation, one could regard the double taxation as ‘acceptable’ under the tax treaty and therefore not compelling the Member State of the receiving company to take action if the MAP proves to be ineffective. Such reasoning, however, was rejected by the ECJ in the *Cobelfret* decision. Fourthly, conflicts of interpretation concerning the term ‘permanent establishment’ do not only result in double taxation, but also in double non-taxation. If the Member State of the receiving company would rely on the proposed solution to resolve double non-taxation, this would be detrimental to the taxpayer. One could argue that a directive that aims to remove tax disadvantages to cross-border restructuring operations cannot have such an effect. This argument, however, is not convincing, as the ECJ’s argumentation for rejecting the ‘inverted’ vertical direct effect of directives in the *Kolpinghuis* decision – a Member State should not be allowed to benefit from its own negligence in implementation – is lacking if the Merger Directive is implemented timely and correctly.

#### *Specification of the exemption method*

Of the different methods of avoiding juridical double taxation that exist, an exemption method that allows losses incurred by a permanent establishment to be offset against the head office’s profits implies a liquidity advantage compared to a pure ‘object exemption’.

In the light of the Merger Directive’s objective, a meaningful provision would oblige the Member State of the receiving company to apply the most favourable method of avoiding double taxation. It became clear in the *Lidl Belgium* decision that the derogatory effect of the freedom of

establishment is incapable of obliging Member States to apply the most advantageous method of eliminating juridical double taxation. Accordingly, to ensure that the establishment and the effective functioning of the internal market is achieved to a larger extent, positive harmonisation (the Merger Directive) should step in where negative harmonisation (the fundamental freedoms) leaves a gap.

An obstacle with the specification of the exemption method is that this could give rise to arbitrary outcomes in comparison with the avoidance of double taxation of the income of a permanent establishment that did not arise out of a cross-border restructuring operation. In addition, if a Member State would be obliged to apply the exemption method, while it previously applied the credit method, it could be argued that this conflicts with the Merger Directive's aim of safeguarding the financial interests of the Member States, although it is not evident that also these taxing rights would be protected.

### *The Merger Directive and 'triangular cases'*

The 'conversion' of a transferring company to a permanent establishment of the receiving company as a result of a restructuring operation can affect the application of the tax treaties concluded by the Member State of the transferring company. For example, dividends, interests, and royalties that were previously received by the transferring company and that are now attributable to the permanent establishment may become subject to a more burdensome taxation and dividends distributed by the receiving company that relate to profits realised with the activities of the (former) transferring company may be taxed differently.

The obligation ensuing from Article 49 of the TFEU to ensure a 'free choice of legal form' does not compel the Member States to remove these disadvantages. When it concerns the taxation of dividends, interests, and royalties attributable to the permanent establishment, it can be derived from the ECJ's *Matteucci* decision that the source Member State should assist the Member State in which the permanent establishment is situated with fulfilling its obligations under EU law. This would imply that the source Member State applies the rate in the tax treaty with the Member State in which the permanent establishment is situated in order to ensure that the tax credit granted by Member State A fully removes the existing juridical double taxation. The insertion of a general provision reflecting the fiscal subrogation by the permanent establishment of the receiving company of the transferring company's fiscal position could serve as a codification of the role of the source Member State, which should continue to apply the tax treaty with the Member State of the transferring company vis-à-vis the permanent establishment of the receiving company. When it concerns the taxation of dividends that relate to profits realised with the activities of the (former) transferring company, a solution could be sought in the tracing of the dividends distributed by the receiving company to the profits realised with the activities of the (former) transferring company that are attributable to a permanent establishment of the receiving company in the Member State of the transferring company.

### 3. Main shortcomings and possible solutions

#### *The Merger Directive's objective is not stated precisely*

If a shortcoming can be defined as a point on which the Merger Directive is deficient in attaining its stated objective, a main shortcoming that has been identified in this thesis is the lack of preciseness of that objective. Although the broad and ambitious objective of removing the tax disadvantages to cross-border restructuring operations is narrowed down to avoiding the “imposition of tax in connection with mergers, divisions, partial divisions, transfers of assets or exchanges of shares” in the fifth recital in the preamble of the Merger Directive, there is still room for doubt when interpreting provisions in the Merger Directive in the light of its objective, requiring clarification by the ECJ. For instance, in the *Zwijnenburg* decision, the ECJ had to clarify that the anti-avoidance provision in (the current, GFB) Article 15(1)(a) of the Merger Directive could only be invoked to refuse the benefits of the Merger Directive if the avoidance of the taxes for which the Merger Directive offers tax benefits is at stake.<sup>902</sup> And in the *3D I* decision, the ECJ had to clarify that the Merger Directive only prohibits immediate taxation at the time of the restructuring operation itself, but not at a later stage.<sup>903</sup>

As (the current, GFB) Article 115 TFEU enables the Council to “issue directives for the approximation of such laws, regulations or administrative provisions of the Member States as directly affect the establishment or functioning of the internal market” it comes as no surprise that removing the “restrictions, disadvantages or distortions arising in particular from the tax provisions of the Member States” hampering cross-border restructuring operations was stated to be “necessary” in the second recital in the preamble “in order to create within the Community conditions analogous to those of an internal market and in order thus to ensure the effective functioning of such an internal market.” While it is obvious that, say, the cross-border merger of an Argentine company into a Uruguayan company would have little effect on the functioning of the internal market and, therefore be outside the Merger Directive’s scope, it is less obvious that that, on the one hand, Article 1(a) Merger Directive requires restructuring operations to involve “companies from two or more Member States” but, on the other hand, does not define the term ‘shareholder’. Why is a company that takes a legal form of a third country not entitled to the Merger Directive’s benefits, but does the Merger Directive grant relief to third country shareholders? And does the ambition to accommodate those restructuring operations that contribute to the “effective functioning of the internal market” in order to allow enterprises to adapt to the requirements of the internal market, to increase their productivity and to improve their competitive strength at the international level impose any requirements in terms of ‘substance’ (i.e., a minimum level of (planned) activity)? It appears from the rather light criteria for qualification as a “company from a Member State” (Article 3 of the Merger Directive) that cross-border restructuring operations involving companies with only limited ‘substance’ should still be facilitated and there is little guidance in the preamble if a Member State can apply Article 15(1)(a) of the Merger Directive to argue that granting tax benefits in such a case would conflict with the Merger Directive’s object and purpose. The lack of precision of the Merger Directive’s objective thus makes it difficult to define exactly what the scope of the Merger Directive’s benefits is and more clarity is required.

### *The Merger Directive does not address domestic restructuring operations*

<sup>902</sup> Case C-352/08, *Modehuis A. Zwijnenburg BV v Staatssecretaris van Financiën* [20 May 2010] ECR I-04303.

<sup>903</sup> Case C-207/11, *3D I Srl v Agenzia delle Entrate - Ufficio di Cremona* [19 December 2012] ECLI:EU:C:2012:433.

The third and fourth recital in the preamble in the Merger Directive state the aim of creating a “common tax system” to remove the disadvantages ensuing from tax provisions that affect cross-border restructuring operations “in comparison with those concerning companies of the same Member State”. If, however, it was really the aim to achieve “neutral[ity] from the point of view of competition” (see the second recital in the preamble in the Merger Directive), it is not clear why the Merger Directive only governs *cross-border* restructuring operations and not *domestic* restructuring operations as well. Now, it remains – at least, in theory – possible that Member States treat *cross-border* restructuring operations (under the Merger Directive) more favourably than *domestic* restructuring operations. In the present author’s view, there are not obstacles to extending the Merger Directive to domestic restructuring operations.

*Minimum harmonisation does not lead to a common tax system*

An inherent tension exists between, on the one hand, the aims of creating “neutral[ity] from a point of view of competition” and “providing a common tax system” and, on the other hand, harmonising only through minimum standards. When certain Member States extend the Merger Directive’s benefits to companies that do not qualify under Article 3 of the Merger Directive or apply the Merger Directive’s also to operations not listed in Article 2 of the Merger Directive, and other Member States do not do that, the desired neutrality or common tax system that could have been achieved through full harmonisation, is not achieved.

*Exhaustive lists are used as legislative technique*

For example, in listing the operations covered (Articles 2(a) – 2(e) and 2(k) of the Merger Directive) or the qualifying legal forms (Annex I, Part A), exhaustive lists are used as legislative technique in the Merger Directive. The flaw of this legislative technique was exposed in the *Gaz de France* decision,<sup>904</sup> by confining the Merger Directive’s benefits to companies taking one of the listed legal forms, without systematically providing for catch-all clauses, a company taking a newly-introduced legal form becomes deprived of the benefits under the Merger Directive. Although the use of exhaustive lists may have its merits with a view to legal certainty, it does not reflect a sufficiently forward-looking mindset. It is, therefore, preferable to demarcate the Merger Directive’s scope through general terms or criteria, although exemplary lists of qualifying operations, legal forms etc. can be used for purposes of legal certainty.

*The Merger Directive does not add much to – and sometimes even frustrates – the outcomes reached through negative harmonisation*

When the Merger Directive was adopted in 1990, only a few ECJ decisions, most notably the *Avoir fiscal* decision,<sup>905</sup> had highlighted – as would become clear in the string of decisions to follow – the extent to which the fundamental freedoms would mould Member States’ domestic tax laws. The decisions reminded Member States that they would have to give the same tax treatment to *cross-border* restructuring operations that they give to *domestic* restructuring operations. So what is the role of *positive* harmonisation (the Merger Directive) in a certain field, when, in the end, the outcome reached is the same as would have been reached through *negative* harmonisation (the fundamental freedoms)? On the one hand, harmonising through specific

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<sup>904</sup> Case C-247/08, *Gaz de France – Berliner Investissement SA v Bundeszentralamt für Steuern* [2 October 2009] ECR I-09225.

<sup>905</sup> Case 270/83, *Commission of the European Communities v French Republic* [28 January 1986] ECR 00273.

directive provisions, instead of a general provision in the TFEU, is preferable with a view to legal certainty. Furthermore, when Member States do not give the same tax treatment to *cross-border* restructuring operations that they give to *domestic* restructuring operations, this may be justified by an imperative requirement in the general interest, which is suitable for securing the attainment of the objective which it pursues and does not go beyond what is necessary in order to attain it. As it is often difficult to assess whether or not a particular restriction of free movement can be justified, it is sensible to offer solutions in a directive, instead of relying on the general free movement provisions.

Against this backdrop one can view the solution in Article 4 of the Merger Directive to require a Member State to grant carry-over relief at company level if a taxable permanent establishment remains behind after a restructuring operation. This solution was offered with the Merger Directive's adoption in 1990, while it would not become clear until the ECJ's *National Grid* decision in 2011 that, if no taxable permanent establishment remains behind, Member States are not prevented from taxing the hidden reserves incorporated in the transferred assets and liabilities, provided that they offer taxpayers the choice between immediate payment of the tax liability or deferral of payment until the hidden reserves are actually realised.<sup>906</sup> It can be derived from this decision that if a taxable permanent establishment does remain behind, a Member State is required to grant carry-over relief as, in that case, the balanced allocation of taxing powers between the Member States is not at risk. While the Merger Directive may have a useful role as 'gap filler', its value is limited when it only codifies imperative of non-discrimination under primary EU law (see, for instance, Article 6 of the Merger Directive). In addition, its value is also limited when it remains silent on certain aspects of restructuring operations, such as the *cross-border* takeover of losses, for which primary EU law does offer a solution (in the *A Oy* decision).<sup>907</sup> Finally, if the Merger Directive's role would be the filling of gaps that remain under the fundamental freedoms, it is difficult to conceive why the Merger Directive would sometimes limit the possibilities that exist under the fundamental freedoms, for example, by narrowing down the scope of companies qualifying for the Merger Directive's benefits.

*The definitions of qualifying restructuring operations in the Merger Directive are not fully aligned with corporate law*

The Merger Directive offers tax relief for restructuring operations that are legally possible. It defines certain restructuring operations similarly – but not identically – as under corporate law (*i.e.*, 'merger' or 'division'), but it also contains definitions of 'own' restructuring operations (*i.e.*, 'transfer of assets' or 'exchange of shares'). Although the definitions in the Merger Directive cannot be viewed in isolation from their corporate law counterparts, the interpretations are not automatically interchangeable due to the different schemes and objectives. In some cases, it is not possible to do under corporate law what is fiscally facilitated (or should be facilitated) under the Merger Directive. In other cases, it is not always possible under the Merger Directive to do what is possible under corporate law. Pursuing an own route in the Merger Directive – that is, separate from corporate law – or aligning the scope of the Merger Directive with the possibilities under corporate law carries a risk of both *overinclusiveness* (tax relief is offered for

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<sup>906</sup> Case C-371/10, *National Grid Indus BV v Inspecteur van de Belastingdienst Rijnmond / kantoor Rotterdam* [29 November 2011] ECR I-12273.

<sup>907</sup> Case C-123/11 *A Oy* [21 February 2013] ECLI:EU:C:2013:84.

operations that cannot be effected under corporate law) and *underinclusiveness* (no tax relief is offered for operations that can be effected under corporate law). An unorthodox option that could be explored – in line with Article 70 of the proposed CCCTB Directive – is to replace the definitions of qualifying restructuring operations by stating that the Merger Directive applies to ‘business reorganisations’. This would tie in with the objective of the Merger Directive, which calls for its benefits being extended to all restructuring operations that potentially give rise to taxation and would, therefore, welcome the use of the broad term ‘business reorganisations’. For the sake of legal certainty, it may also be considered to list the current operations in Articles 2(a) – 2(e) of the Merger Directive as examples of operations that are covered by the term ‘business reorganisations’.

*The Merger Directive is silent on the procedural requirements that Member States are allowed to impose*

In the *A.T.* decision,<sup>908</sup> the ECJ held that Member States are not allowed to make the Merger Directive’s benefits dependent on additional *material* conditions and it stressed that a refusal of the benefits of the Merger Directive is only expedient in the case of tax avoidance. In the *Pelati* decision,<sup>909</sup> however, the ECJ held that additional *procedural* rules could be left outside the straightjacket of Article 15(1)(a) of the Merger Directive. In other words, Member States may require certain procedural requirements to be met, before the Merger Directive’s benefits are granted. This carries that the risk that the working of the Merger Directive is frustrated by meaningless procedural requirements, provided that they are sufficiently clear and foreseeable, applied non-discriminatorily and do not make it “excessively difficult” to exercise the rights derived from the Merger Directive. The respect for the procedural autonomy of the Member States within the ambit of the Merger Directive leaves a diversity of procedural rules in place and this does not tally with the aim of creating a “common tax system”. Given the possibilities offered by the anti-avoidance provision in the Merger Directive, coupled with the EU machinery of information exchange and recovery assistance, it is in the present author’s view doubtful if it necessary to impose procedural requirements at all. But if they are imposed, they should at least be inserted in the Merger Directive itself.

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<sup>908</sup> Case C-285/07, *A.T. v Finanzamt Stuttgart-Körperschaften* [11 December 2008] ECR I-09329.

<sup>909</sup> Case C-603/10, *Pelati d.o.o. v Republika Slovenija* [18 October 2012] ECLI:EU:C:2012:639.